

Message Text

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TO TREASURY DEPT WASHDC PRIORITY

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C O N F I D E N T I A L SECTION 01 OF 02 LONDON 05032

LIMDIS GREENBACK

PASS FEDERAL RESERVE BOARD

.O. 11652: XGDS

TAGS: EFIN, UK

SUBJECT: HM TREASURY ON INTERNATIONAL MONETARY MATTERS

REF: LONDON 4661

SUMMARY: EC MONETARY COMMITTEE SESSION WEEK MARCH 28 WILL BE DEVOTED LARGELY TO PREPARATION FOR APRIL INTERIM COMMITTEE SESSION, INCLUDING POSSIBLE 50 PERCENT INCREASE IN QUOTAS. SOME OFFICIALS IN HM TREASURY AND BANK OF ENGLAND ARE PREPARED TO SET TARGET ZONES FOR POUND. U.K. IS TAKING SOFTER LINE IN PUSHING GERMANS TO REFLATE. COMMONWEALTH EXPERT GROUP REPORT ON REFORM OF IMF UNREALISTIC, TILTS OVERLY IN FAVOR OF LDC BORROWERS, AND WILL CAUSE U.K. SOME EMBARRASSMENT. U.K. EXPECTS TO MEET EASILY ALL IMF CONDITIONS AT MAY PERFORMANCE REVIEW, BUT SOME IMF OFFICIALS STILL PRESSING FOR REDUCTION IN EXCHANGE RATE, WHICH U.K. OPPOSES. U.K. DOES NOT EXPECT TO HAVE MUCH SUCCESS IN SELLING FOREIGN CURRENCY BONDS TO OFFICIAL STERLING HOLDERS UNDER BASLE AGREEMENT; LONGER TERM THINKING INCLUDES HOW TO ADJUST
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TO OR AVOID POSSIBILITY OF UPWARD PRESSURE IN THE EXCHANGE RATE. END SUMMARY.

1. U.K. TREASURY SOURCE WHO ATTENDS EC MONETARY COMMITTEE TELLS FINANCIAL ATTACHE THAT EC MONETARY COMMITTEE SESSION TO BE HELD WEEK OF MARCH 28 WILL DEAL ALMOST EXCLUSIVELY WITH PREPARATION OF APRIL INTERIM COMMITTEE

AGENDA. SOURCE BELIEVES THE MONETARY COMMITTEE WILL RECOMMEND A 50-PERCENT INCREASE IN IMF QUOTAS FOR ALL MEMBERS, SO THAT THERE WILL BE NO NEED FOR CONTENTIOUS DISCUSSIONS OF SELECTIVE PROPORTIONAL CHANGES IN QUOTAS OR VOTING SHIFTS, WHICH SOURCE CONSIDERED WOULD CAUSE DIFFICULTIES FOR U.S. AND SOME OTHER MEMBERS.

2. WHEN DISCUSSING EC EXCHANGE RATE TARGET ZONE PROPOSALS, SOURCE INDICATED THAT THERE HAD BEEN DIFFERENCES OF OPINION WITHIN U.K. GOVERNMENT ON THEIR DESIRABILITY. FAIRLY SENIOR CAREER STAFF IN HMT AND BANK OF ENGLAND SUPPORTED THE ESTABLISHMENT OF AN EXCHANGE RATE TARGET ZONE FOR THE U.K., THE BOE PREFERRING AN EVEN HIGHER OUTER LIMIT THAN HMT. THESE VIEWS, HOWEVER, WERE NEVER PUT TO MINISTERS FOR A DECISION. AS NOTED REFTEL, OTHERS IN HMT TOOK A MORE NEGATIVE POSITION ON TARGET ZONES.

3. IN PREPARING BRIEFS FOR PM CALLAGHAN'S SESSION WITH OTHER EC HEADS OF GOVERNMENTS, HMT CAUTIONED CALLAGHAN TO AVOID CONFRONTATION WITH THE GERMANS ON GERMAN GROWTH RATES. RATIONALE IS THAT THE GERMANS COULD BE RIGHT IN STATING THAT THEY WILL MEET THEIR TARGETS. LINE OF ARGUMENT BEING GIVEN TO CALLAGHAN IS THAT HE SHOULD EXPRESS HOPE THAT THE GERMANS DO MEET THE GROWTH TARGETS THEY EXPECT, GIVEN THE IMPORTANCE TO OTHER EC MEMBERS.

4. FINANCIAL ATTACHE QUERIED SOURCE CONCERNING REPORT IN LONDON TIMES OF 3/21, THAT A COMMONWEALTH EXPERT
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GROUP WAS RECOMMENDING THE MOST FAR-REACHING REFORM OF THE IMF SINCE ITS INCEPTION. WOULD IT BE POSSIBLE TO OBTAIN A COPY OF REPORT? SOURCE REPLIED NOT AT THE MOMENT; A FINISHED TEXT DOES NOT EXIST. WHAT HAS BEEN LEAKED TO THE PRESS REFLECTS CONTENTS OF A FINAL DRAFT, ROUGHLY 100 PAGES LONG, OF WHICH HM TREASURY ONLY HAS ONE BORROWED COPY. IT REPEATS "EVERYTHING THAT HAS EVER BEEN PROPOSED" ABOUT THE IMF. THE REPORT GENERALLY TERMED "AWFUL" ADVOCATING AMONG OTHER THINGS INCREASED COMMODITY PRICES AS A FORM OF STABILIZATION, SOFTER IMF LENDING TERMS, AND ONE-MAN-ONE-VOTE RATHER THAN WEIGHTED VOTING IN THE IMF. THE U.K. WILL FIND IT IMPOSSIBLE TO APPROVE OR ADOPT THE DOCUMENT. THIS WILL BE EMBARRASSING AT THE COMMONWEALTH MEETING TO BE HELD IN LONDON IN JUNE WHERE CALLAGHAN WILL BE OUTNUMBERED ROUGHLY 40 TO 1. THE U.K.'S EXPERT ON THE GROUP, MR. SIDNEY GOLT, IS A RETIRED DEPUTY SECRETARY FROM THE BOARD OF TRADE.

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LIMDIS GREENBACK

5. DISCUSSING IMF/BASLE CONSIDERATIONS, SOURCE SAID THE IMF TEAM WOULD BE BACK IN THE U.K. ABOUT MAY 20 TO MONITOR PERFORMANCE. PSBR OUTCOME FOR CURRENT AND FOR NEXT FISCAL YEAR DOES NOT PRESENT ANY PROBLEMS, NOR DO THE DCE AND MONETARY AGGREGATE TARGETS. PUBLIC EXPENDITURE IS FIRMLY UNDER CONTROL. POSSIBLE PROBLEMS COULD ARISE OVER THE EXCHANGE RATE LEVEL. IMF OFFICIALS (POLLOCK AND ARTIS) WOULD PREFER TO HAVE THE RATE LOWER THAN THE BRITISH DESIRE.

6. THE U.K. OFFER TO SELL FOREIGN CURRENCY BONDS UNDER THE BASLE AGREEMENT PROBABLY WON'T BE TOO SUCCESSFUL. U.K. BELIEVES IT WOULD DO WELL TO SELL \$500 MILLION TO OFFICIAL STERLING HOLDERS. THE U.K. ASSUMES THAT BASLE PARTICIPANTS DO NOT HAVE ANY FIXED TARGETS IN MIND. RESULTS OF INITIAL CONVERSATIONS WITH STERLING HOLDERS INDICATE THAT WHEREAS SOME OF THEM DO NOT NOW WISH TO SHIFT FROM STERLING TO FOREIGN CURRENCY BONDS, THEY MAY DO SO WHEN EXISTING STERLING HOLDINGS MATURE.

7. LOOKING AHEAD, HMT IS GIVING THOUGHT TO HOW TO DEAL WITH INFLOWS RESULTING FROM EXPECTED BALANCE OF PAYMENTS
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SURPLUS NEXT YEAR AND THEREAFTER. CHOICES OBVIOUSLY INCLUDE (A) ALLOWING THE RATE TO TAKE THE UPWARD PRESSURE OR (B) ALLOWING THE RESERVES TO INCREASE AND EXPORTS AND IMPORT SUBSTITUTES TO BENEFIT. HMT PREFERS THE LATTER CHOICE, ALTHOUGH IF RESERVES ARE ALLOWED TO INCREASE THERE WILL BE DOMESTIC PRESSURE FOR REFLATION. CONSIDERATION IS BEING GIVEN TO MATCHING INFLOWS BY FOREIGN CURRENCY OUTFLOWS, BY ALLOWING LIMITED FOREIGN BOND ISSUES IN THE U.K. MARKET AND AGAIN PERMITTING STERLING TO FINANCE THIRD COUNTRY TRADE. BOTH THESE FORMS OF CAPITAL OUTFLOWS CAN BE FAIRLY CLOSELY REGULATED AND REVERSED AS NECESSARY.

8. SOURCE DID NOT BELIEVE THERE WOULD BE ANY MEANINGFUL PRESSURE FROM EC PARTNERS TO LIBERALIZE CAPITAL MOVEMENTS UNDER ARTICLE 124 OF U.K. ACCESSION DOCUMENT TO THE EC, EXCEPT ON DIRECT INVESTMENT. THIS SHOULD NOT BE A PROBLEM IN AS MUCH AS IT ALREADY CAN BE FINANCED EXTERNALLY. RATHER, STRONGER DOMESTIC PRESSURE IS ANTICIPATED TO INCREASE EMIGRATION ALLOWANCES WHICH WERE TERMED UNREALISTICALLY LOW AND TO ABOLISH 25 PERCENT GIVE-UP ON FOREIGN CURRENCY PROCEEDS FROM SALES PROCEEDS IN THE INVESTMENT CURRENCY MARKET.

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